INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute involved	2
Statement	3
Specification of errors to be urged	4
Reasons for granting the writ	5

CITATIONS

Cases:	
Bank v. *Tennessee*, 104 U.S. 493	7
Bank of Commerce v. *Tennessee*, 161 U.S. 134	7
Blair v. *United States*, 63 C.Cls. 193, certiorari denied, 275 U.S. 546	6
Brewster v. *Gage*, 280 U.S. 327	8
Cornell v. *Coyne*, 192 U.S. 418	7
Heiner v. *Colonial Trust Co.*, 275 U.S. 232	8
Lynch v. *Hornby*, 247 U.S. 339	6
Massachusetts Mutual Life Ins. Co. v. *United States*, 288 U.S. 269	8
Morris Canal Co. v. *Baird*, 239 U.S. 126	7
Murphy Oil Co. v. *Burnet*, 287 U.S. 299	8
National Lead Co. v. *United States*, 252 U.S. 140	8
Thorsen, William R. v. *Commissioner*, C.C.A. 9th, decided May 19, 1933	5, 7
Statutes:	
Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 201	2–3
Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 201 (U.S.C., Title 26, Sec. 932)	8
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 201 (U.S.C. App., Title 26, Sec. 932)	8
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 115	8
Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 115 (U.S.C. Sup. VI, Title 26, Sec. 115)	8
Miscellaneous:	
A.R.M. 82, 3 Cumulative Bulletin 36	8
G.C.M. 3532, VII–1 Cumulative Bulletin 190	8

In the Supreme Court of the United States

OCTOBER TERM, 1933

No. —

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

CHARLES J. CANFIELD

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit entered in the above cause on January 13, 1933, reversing a decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 28a–28j) is reported in 24 B.T.A. 480. The opinion of the Circuit Court of Appeals (R. 42) is reported in 62 F. (2d) 751.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 13, 1933 (R. 46). By order of this Court dated April 11, 1933, the time within which petition might be filed was extended to and including June 10, 1933 (R. 49). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, for the purpose of fixing the taxable status of a dividend declared and paid in 1923, losses incurred in 1915 and 1916 should be used to reduce the 1913 surplus or the profits accumulated from 1917 to 1923.

STATUTE INVOLVED

Revenue Act of 1921, c. 136, 42 Stat. 227, 228:

> SEC. 201. (a) That the term "dividend" when used in this title (except in paragraph (10) of subdivision (a) of section 234 and paragraph (4) of subdivision (a) of section 245) means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, except a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.

(b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. If any such tax-free distribution has been made the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent that, the basis provided in section 202 exceeds the sum of (1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon.

STATEMENT

Charles J. Canfield was, at all times here material, a stockholder in the West Side Lumber Company, a California corporation, holding 600 of its total issue of 15,000 shares, having a par value of $100 each (R. 28b).

The West Side Lumber Company had a surplus of $4,332,684.78 on March 1, 1913, which was increased to $5,093,120.71 by April 14, 1923, when the dividend in question was declared. The company

realized a small profit during the year ended February 28, 1914; sustained large losses in the years ended February 28, 1915 and February 29, 1916, and realized substantial profits in the succeeding years to and including the fractional period ended April 14, 1923. (R. 28b.) Dividends were declared from 1918 to 1923 aggregating $1,291,000. On April 14, 1923, the company declared and paid a dividend of $5,100,000, or $340 per share, of which the respondent received $204,000. (R. 28c.)

The Commissioner of Internal Revenue contended before the Board of Tax Appeals that this dividend was 22.75 percent taxable while the respondent alleged it to be only 14.91 percent taxable (R. 28c–28d). The difference depends upon the proper application of the losses sustained in 1915 and 1916. These losses were treated by the petitioner as reducing preexisting surplus while the respondent asserted they should be deducted from the income subsequently earned for the purpose of ascertaining the most recently accumulated earnings or profits subject to tax. The majority of the Board of Tax Appeals sustained the ruling of the Commissioner (R. 28d–28i). The Circuit Court of Appeals reversed (R. 46).

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in holding that the most recently accumulated earnings or profits subject to tax as dividends in the hands of stockholders are limited to the *net* profits realized

throughout the entire period intermediate February 28, 1913, and the date of dividend distribution.

2. The Circuit Court of Appeals erred in holding that corporate surplus existing as of March 1, 1913, must be considered as capital and if impaired may be replaced notwithstanding it has actually been risked and in part lost in the conduct of the business prior to the dividend distribution.

3. The Circuit Court of Appeals erred in failing to approve the method employed by the Commissioner of Internal Revenue whereby the taxable status of corporate distributions is fixed by first applying the profits realized in the period immediately preceding the dividend followed by those of the prior years in inverse order to March 1, 1913, with allowance for dividends earlier paid, treating each year as a separate unit.

4. The Circuit Court of Appeals erred in reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below presents a direct conflict with that of the Circuit Court of Appeals for the Ninth Circuit in *William R. Thorsen* v. *Commissioner,* decided May 19, 1933, not yet reported. The *Thorsen case* involved another stockholder of the same corporation and the two cases were consolidated for hearing and decision before the Board of Tax Appeals. The decision of the Board was affirmed in the *Thorsen case* and reversed in the instant case.

The decision of the court below is believed to be in conflict with that of the Court of Claims in *Blair* v. *United States,* 63 C.Cls. 193, certiorari denied, 275 U.S. 546. There is much of analogy in the fiscal experience of the corporations involved in the *Blair case* and the present case. There, as here, there was a surplus on March 1, 1913. This was followed by losses in 1914 and 1915 and gains in 1916, 1917, and 1918. The dividend was declared and paid in 1918. The taxpayer was held properly taxable upon the full amount of the distribution received by him. The court below made no reference to the *Blair case,* although it was cited in the majority opinion of the Board of Tax Appeals and relied upon by the petitioner.

2. The decision of the court below is believed to be unsound. There is nothing inherent in the nature of corporate dividends which renders them immune to taxation. As gain derived from capital, they are within the spirit as well as the letter of the statutory definition of gross income. Whatever of exemption exists springs from the language of the statute (*Lynch* v. *Hornby,* 247 U.S. 339), the material portion of which reads (Section 201 (b), *supra*):

> * * * any earnings or profits accumulated * * * prior to March 1, 1913, may be distributed exempt from the tax, * * *.

Clearly the situation calls for the rule announced by this Court that in favor of exemption nothing

is to be taken lightly as by inference or presumption. *Bank* v. *Tennessee,* 104 U.S. 493, 495; *Bank of Commerce* v. *Tennessee,* 161 U.S. 134, 146; *Cornell* v. *Coyne,* 192 U.S. 418, 431; *Morris Canal Co.* v. *Baird,* 239 U.S. 126.

The decision below necessarily ignores the accepted principles of accounting and the actualities of the situation. Practically, as well as from a bookkeeping standpoint, there is no such thing as a coexisting surplus and an operating deficit. When the company sustained large losses in 1915 and 1916 it made them good from its preexisting surplus. The losses of 1915 and 1916 could not be suspended until profits should be realized in later years, if ever. Neither is there any basis for assuming that earned surplus existing on March 1, 1913, is invested with the attributes of capital for all purposes so that it may be replaced if impaired although it has in fact been risked and in part lost in the conduct of the business. Such a contention was advanced and rejected by the court in the *Thorsen case* after careful analysis of several cognate decisions of this Court. The position adopted by the court below would necessarily permit income earned *any* number of years after March 1, 1913, to be treated as profits accumulated before March 1, 1913. Such a result might possibly be justified where required by the express mandate of an unambiguous statute; certainly it should not be sanctioned where predicated upon a strained construction of a doubtful statute.

The decision of the Circuit Court of Appeals runs counter to the settled and consistent administrative interpretation of the statute.[1] With this construction before it the Congress has repeatedly reenacted the substance of the statute without material change.[2] The case is clearly one of legislative recognition and approval of a fixed administrative construction. *National Lead Co.* v. *United States*, 252 U.S. 140; *Brewster* v. *Gage*, 280 U.S. 327, 336; *Murphy Oil Co.* v. *Burnet*, 287 U.S. 299, 302–303. A mistaken interpretation would, it is reasonable to assume, have been corrected specifically in the later revisions of the statute. *Heiner* v. *Colonial Trust Co.*, 275 U.S. 232, 235; *Massachusetts Mutual Life Ins. Co.* v. *United States*, 288 U.S. 269, 273.

3. The question is one of importance in the administration of the revenue laws. It arises under all the taxing Acts. The Bureau of Internal Revenue informs us that there are now pending a large number of cases the disposition of which depends upon the correct answer to the question here involved. The Bureau estimates upon the basis of data which is admittedly incomplete that the deter-

[1] A.R.M. 82, 3 Cumulative Bulletin 36 (1920); G.C.M. 3532, VII–1 Cumulative Bulletin 190, 191–193 (1928).

[2] Section 201 (a) and (b), Revenue Acts of 1924, c. 234, 43 Stat. 253, 254 (U.S.C., Title 26, Sec. 932), and 1926, c. 27, 44 Stat. 9, 10 (U.S.C.App., Title 26, Sec. 932); Section 115 (a) and (b), Revenue Acts of 1928, c. 852, 45 Stat. 791, 822, and 1932, c. 209, 47 Stat. 169, 203 (U.S.C.Sup. VI, Title 26, Sec. 115).

mination of this question will directly affect the revenue upon approximately $20,000,000 per year, currently and for some years to come.

Wherefore it is respectfully submitted that this petition should be granted.

J. CRAWFORD BIGGS,
Solicitor General.

JUNE 1933.

U. S. GOVERNMENT PRINTING OFFICE: 1933